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June 19, 2006

AGENDA ITEM 10-A

TO: MEMBERS OF THE INVESTMENT COMMITTEE

I. SUBJECT: Assembly Bill 2570 (Arambula) –
As Amended May 26, 2006

Community Investment: State and Local Retirement Systems

Sponsor: California Association for Local Economic Development

II. PROGRAM: Legislation

III. RECOMMENDATION: Neutral

The reporting requirements in this bill would not significantly impact the administration of the System.

IV. ANALYSIS:

The Legislature finds that investments in emerging domestic markets can provide institutional investors, including public pension funds, with appropriate risk-adjusted returns.

Both the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) previously implemented fund policies to encourage investment in national and domestic emerging markets. This bill intends for other public retirement systems (excluding CalPERS and CalSTRS) with sufficiently diversified portfolios to adopt emerging domestic market investment policies that meet their own unique investment objectives, consistent with their fiduciary obligations.

In addition, this bill would require CalPERS and any other public retirement systems with assets over \$4 billion to report asset category, fair market value, and percentage of portfolio for all investments in California and all assets in emerging domestic markets within the state as part of its annually audited financial statement submitted to the Controller.

Background

CalPERS' Economically Targeted Investment Program

Approved by the Board in 2000, the Economically, Targeted Investment (ETI) Program was established to assist in the improvement of both national and regional economies, and the economic well being of the State of California, its localities and residents. Economic stimulation includes job creation, development, and savings; business creation; increases or improvement in the stock of affordable housing; and improvement of the infrastructure.

CalPERS' primary objective of this program is to provide competitive risk-adjusted rates of return while promoting growth and development of national and regional economies. The secondary objective is to promote economic growth and well-being in the State and its localities when not in conflict with the Board's fiduciary responsibilities to the System.

CalPERS' California Emerging Markets Investment Policy

A component of the ETI Program is CalPERS' California Emerging Markets Investment Policy (Policy). The Policy's primary objective is to achieve competitive risk adjusted rates of return while broadening economic opportunity in California's underserved areas. California emerging market investments are defined as investment opportunities in traditionally underserved markets, located in California, such as urban and rural areas undergoing revitalization where assets conducive to business development exist. The Policy sets a goal of 2% of the CalPERS total portfolio.

The policy for Emerging Market Investments includes two other distinct goals: 1) for allocation purposes, California Emerging Market Investments are to be included with similar investments in asset classes including fixed income, private equity, and real estate; and 2) staff must monitor and annually report investment performance to the Board.

The decision to invest in underserved markets and consideration of its broader benefits only occur after the investment is deemed acceptable to the fund exclusively on its own economic investment merits. California Emerging Market Investment, whether in a stand-alone portfolio or incorporated with like investments which have no emerging market-targeted orientation, are priced at least at market prices and are subject to applicable performance measurements.

The existence of this Policy is not construed as a mandate to invest in ETIs, but rather should be viewed as an additional set of suggested parameters within which to consider such investments.

Public Retirement Systems Annual Report

Government Code Section 7501 – 7504 directs the California State Controller to annually compile and report to the public the financial condition of California's retirement systems. All state and local public retirement systems are required to submit audited financial statements to the State Controller within six months of the close of each fiscal year. Data from these individual reports are compiled and analyzed with the results published in the *Public Retirement Systems Annual Report*.

California Economic Strategy Panel

The bipartisan California Economic Strategy Panel was established in 1993 to develop an overall economic vision and strategy to guide public policy. The Panel engages in collaborative biennial planning processes that examine economic regions, industry clusters, and cross-regional economic issues. The Panel also examines factors affecting growth such as capital, infrastructure, taxes, regulations, workforce development, and research and development activity.

The Panel is responsible for developing a standard definition of economic development; conducting studies related to the economic development sections of the state budget; developing a system of accountability in the state budget and legislative process; and measuring the performance of all state policies, programs and tax expenditures intended to stimulate the economy.

Proposed Changes

The Legislature recognizes the efforts put forth by CalPERS and CalSTRS regarding investments in emerging domestic markets with the State; consequently this bill intends for other public retirement systems with sufficiently diversified portfolios to adopt emerging domestic market investment policies that meet their own unique investment objectives, consistent with their fiduciary obligations.

This bill also requires the California Economic Strategy Panel in consultation with public pension funds with assets over \$4 billion to develop a definition for emerging domestic markets by October 1, 2007, and update it every five years. All state and local pension funds with assets over \$4 billion shall report yearly to the Controller, as part of their audited financial statements, all assets in California and in emerging domestic markets, based on asset category, fair market value, and percentage of the total portfolio.

Legislative History

2003 AB 849 (Lieber) – would have required state or local agencies that invest public funds and purchases financial instruments from financial institutions to utilize a financial institution that has an outstanding rating under the federal Community Reinvestment Act. Failed Passage. *CalPERS' position: None.*

1993 AB 1756 (Tucker) – Would have created the California Community Reinvestment Act which prohibits CalPERS from contracting with financial institutions whose assets exceed \$100 million if these institutions fail to submit annual reports to the State Treasurer's Office regarding lending and investment practices, with regard to race, ethnicity, gender and income of the boards and recipients of loans and contracts from the institutions. Died on File. *CalPERS' position: Oppose.*

AB 3532 (Escutia) – Would have authorized the CalPERS Board to consider investment in public infrastructure development projects. Died in Committee (in 1994). *CalPERS' position: Neutral*

1992 Chapter 622, Statutes 1991 (AB 952, Quackenbush) – Specifies that CalPERS maintain not more than 1 percent of the book value of its assets in small business venture capital and extends the repeal date to January 1, 1995. *CalPERS' position: Neutral*

AB 2317 (Moore) – Would have authorized CalPERS to consider joint venture, subcontracting, and investment-related relationships with women business enterprises, minority business enterprises and disabled veteran business enterprises to meet statewide participation goals. Vetoed by Governor. *CalPERS' position: Neutral*

AB 45X (Peace) – Would have prohibited governmental agencies from contracting for services with financial institutions with \$100 million or more in assets unless those companies file annual reports with the Controller which contain specified information relating to how they are helping to meet the needs of the local community that they serve. Died in Committee (in 1992). *CalPERS' position: Oppose*

Chapter 540, Statutes 1992 (SB 1957, Thompson) – Would delete the sunset provision in the statute which requires CalPERS to give first priority to investing not less than 25 percent of all funds which became available in a fiscal year for new investments in California residential realty. *CalPERS' position: Neutral.*

Issues

1. Arguments by Those in Support

According to the author, California lacks a comprehensive strategy for attracting private investment. As one of the largest economies in the world, California has the ability to encourage private investment which could result in increased financial opportunities for the State's underserved capital markets.

Organizations in Support: California Association for Local Economic Development (Sponsor)

2. Arguments by Those in Opposition

There is no known opposition at this time.

3. Reporting Requirement is Consistent with our Disclosure Policy

The reporting requirements outlined in this bill are consistent with the format already used to provide annual audited financial statements to the State Controller as required by statute. Therefore we can accommodate the reporting requirements proposed in this bill by including a breakdown of assets in emerging domestic markets within the Comprehensive Annual Financial Report.

4. Legislative Policy Standards

The Board's Legislative Policy Standards suggest a neutral position on proposals which do not significantly affect the benefit interests of our stakeholders and which do not significantly impact CalPERS' benefits or the administration of the system. AB 2570 would require CalPERS to submit annual audited financial statements to the State Controller which would include information on investments in California and all assets in emerging domestic markets within the state, based on asset category, fair market value, and percentage of the total portfolio.

V. STRATEGIC PLAN:

This item is not a product of the CalPERS strategic plan, but an ongoing responsibility of the CalPERS Office of Governmental Affairs.

VI. RESULTS/COSTS:

Program Costs

There are no known program costs at this time. CalPERS already supports a policy of investment in emerging domestic markets within the state. If the definition created by the Economic Strategy Panel grossly differs from CalPERS' definition, program costs may arise if investment restructuring is required.

Administrative Costs

Administrative costs will be minimal, requiring slight modification to reports already submitted to the Controller. Additional administrative costs may apply if the definition of emerging domestic markets developed by the Economic Strategy Panel grossly differs from CalPERS' definition.

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